DOCKET FILE COPY ORIGINAL

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Telecommunications Services	)	
Inside Wiring	)	CS Docket No. 95-184
	)	
Customer Premises Equipment	)	
	)	
In the Matter of	)	
	)	
Implementation of the Cable	)	
Television Consumer	)	MM Docket No. 92-260
Protection and Competition	)	
Act of 1992	)	
	)	
Cable Home Wiring	)	

SURREPLY OF AMERITECH
ON SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

I. Introduction

Ameritech New Media, Inc. ("Ameritech") respectfully submits this surreply to the reply comments of the Independent Cable & Telecommunications Association (ICTA) and OpTel, Inc. (OpTel) concerning the Commission's Second Further Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.

Throughout this proceeding, Ameritech has argued that exclusive service contracts have been used extensively by incumbent cable operators and other MVPDs to lock up MDU properties, and thereby preclude competition and consumer choice in the delivery of video programming to MDU tenants. Ameritech has also refuted the self-serving claims of certain, high cost MVPDs, including private cable operators (PCOs) represented by the ICTA, and incumbent cable operators that exclusive service arrangements can have various procompetitive benefits in the MDU context. In particular, Ameritech has demonstrated that exclusivity is not necessary to enable new entrants to attract investment and recover the costs of new installations, or to ensure that MDU tenants have access to high quality, technologically advanced services at reasonable rates. Accordingly, Ameritech has asked the Commission to prohibit MVPDs from entering into, or enforcing, exclusive service contracts for MDUs in order to ensure that all Americans, including MDU tenants, benefit from increased competition and consumer choice in the delivery of multichannel video programming.[1]

II. Discussion

In their reply comments, ICTA and OpTel once again attempt to convince the Commission that, despite clear evidence to the contrary, exclusive service contracts between competitive MVPDs and MDUs are procompetitive, and, therefore, should not be regulated. To support their position, ICTA and OpTel offer a study by Professor Michael Whinston that purports to analyze the competitive effects of exclusive contracts between MVPDs, particularly PCOs, and MDU owners.[2] This self-serving study, which was financed by ICTA and OpTel,[3] is, however, fundamentally flawed for several reasons.

In his report, Professor Whinston opines that "there is little risk of competitive harm arising from the use of exclusive contracts by PCOs," and that "exclusive

---

1 Ameritech urged the Commission to limit strictly the duration of such contracts to the minimum period necessary for MVPDs to recover their investment costs if the Commission nevertheless decides not to prohibit exclusive service arrangements for MDUs.

2 Michael D. Whinston, Report on the Competitive Effects of Exclusive Contracting for Video Programming Services in Multiple Dwelling Units (Attachment A to the Reply Comments of the Independent Cable & Telecommunications Association) ("Whinston Study").

3 *See* OpTel Reply at 1.

contracting with PCOs serves an important pro-competitive role in [the MDU market], and in particular, may be essential for assuring the competitive participation of PCOs in this market."[4] Professor Whinston bases these conclusions on the premise that an exclusive contract is necessarily efficient unless third parties who are impacted by the contract are excluded from negotiations concerning the contract,[5] and his assumption that such third parties are not excluded from negotiations in the MDU context. This fundamental assumption -- that third parties are not excluded from the negotiations of exclusive service contracts for MDUs -- is, however, incorrect. Professor Whinston fails to consider the impact of exclusive service contracts on new entrants that were not yet operational when existing exclusive service contracts were executed, and that MDU owners still have few options when negotiating exclusive contracts.[6] To the extent that there are only two, or a few, parties to the negotiation (such as the franchised cable operator and one or two PCOs), it is not at all clear that the resulting contract would be efficient or competitive. Indeed, where there are few service providers present in the market, there is a significant risk that the parties may agree tacitly to share the market, and raise prices to consumers.

In addition to relying on a faulty premise, Professor Whinston offers little or no evidence or factual data to support his analysis. Professor Whinston claims, in *pro forma* fashion, that in "analyzing competition in the market for video programming in MDUs, [he] . . . examined documents and reports relevant to competition in this market, . . .

---

[4] Whinston Study at 2.

[5] Whinston Study at 3-4. Whinston asserts that, "to present a threat to the efficiency of market outcomes, [an] exclusive contract must generate some kind of external effect on third parties," and that "for an anticompetitive exclusive contract to be signed, the third parties who are impacted by the contract must not be present in the bargaining and negotiations over the contract in question. *Id.* (arguing that if all parties impacted by the relevant contract are present, they would have an incentive, and be able, to make offers that mitigate the negative impacts they anticipate from the contract in question).

[6] As discussed below, Professor Whinston also incorrectly discounts the impact of exclusive service contracts on MDU tenants who also are not a party to, or effectively represented in, the contract negotiations.

reviewed comments filed in this proceeding, and . . . interviewed a *number* of PCOs and MDU owners."[7] Professor Whinston fails, however, to identify what documents and reports he reviewed, what those documents and reports revealed, how many and which PCOs and MDU owners he interviewed, the geographic markets in which such PCOs operate and MDU owners are located, what information he solicited and obtained from those PCOs and MDU owners, or whether he interviewed any other MVPDs. As a result, the Commission and other interested parties are unable to assess independently the basis for Professor Whinston's opinions. The Commission should, therefore, approach this self-serving study offered by ICTA and OpTel with scepticism, and rely on its own assessment of the evidence and relevant economics.[8]

In addition, Professor Whinston's opinion that PCOs likely cannot use exclusive contracts to reduce competition in the MDU market and earn supra-normal profits is based on his assessment that the provision of video services by PCOs is characterized by low economies of scale.[9] No data, however, are offered to support this assessment. But even if PCOs have small economies of scale, this would not prevent a PCO from using exclusive contracts to limit competition in the MDU video services market. To the contrary, the lack of economies of scale suggests that a PCO might attempt to use such contracts as a means of foreclosing competition by more efficient video service providers, such as cable service providers and DBS providers, which have significantly greater economies of scale.

---

7 *Id.* at 2 (emphasis added).

8 As discussed below, the available evidence suggests that exclusivity is not essential to facilitate investment in the MDU market, even by PCOs, as demonstrated by the Commission's finding in the *Fourth Cable Competition Report* that the growth markets for SMATV firms are in, *inter alia*, Florida, and major urban centers, like Chicago and New York, each of which has some form of mandatory access law, and, therefore, prevents SMATVs from entering into exclusive service arrangements for MDUs. *See Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, CS Docket No. 97-141, Fourth Annual Report, FCC 97-423 at para. 84 (rel. Jan. 13, 1998) (*Fourth Cable Competition Report*).

9 Whinston Study at 2.

Professor Whinston also significantly overstates the extent to which MDU owners act as effective proxies for tenants in negotiations, and therefore disregards the negative external effect of exclusive service contracts on MDU tenants. Specifically, Professor Whinston contends that MDU owners are forced to act as *de facto* representatives for their tenants in negotiations with MVPDs because of competition in the market for real estate rentals.[10] Competition in the downstream real estate rental market will not, however, necessarily force MDU owners to represent effectively their existing and potential tenants in negotiations with MVPDs. Because the cost and quality of video services are likely to be *de minimis* in relation to MDU rental and other costs associated with locating and moving into an MDU, and other factors (such as MDU location and availability of other amenities) are far more likely to influence a tenant's choice of MDU, it is highly unlikely that the cost and quality of video services will have a significant impact on a tenant's decision to rent, or remain in, a particular MDU.[11] Moreover, although supra-competitive prices for video services may have relatively little effect on an individual tenant's decision to rent, when spread across an entire building, they could strongly influence a MDU owner's decision to contract with a particular MVPD if the MVPD shares monopoly rents with the MDU owner. As a result, MDU owners may have a strong incentive to grant MVPDs exclusive access to their buildings in return for a share of the MVPDs' monopoly profits, rather than seeking the best mix of video service quality, quantity and price on behalf of their tenants.

---

[10] Whinston Study at 6 (claiming that a failure to act on behalf of their tenants would jeopardize a MDU owner's ability to rent its units).

[11] The demand of MDU tenants for video services is likely to be relatively inelastic because of the significant costs (in time and money) associated with locating, and moving into, a new MDU. Few tenants, for example, would be willing to incur the hundreds, if not thousands, of dollars in moving expenses, in addition to the time and aggravation associated with finding a new apartment, in response to a small, but significant rate increase for video services. As a result, a MDU owner may conclude that it would benefit from executing an exclusive service arrangement with a high-priced MVPD, in return for a portion of the MVPD's revenue, without jeopardizing its ability to rent its units.

Indeed, Professor Whinston's own data suggests that exclusive service contracts may allow PCOs to exercise market power by, for example, charging supra-competitive prices. According to Professor Whinston's statement, an ICTA survey of some of its members (including some of the largest PCOs) indicated that respondents "had an average of 10,600 passings and 5,412 subscribers in the cities in which they were active," or a penetration rate of 53.8 percent.[12] This penetration rate is substantially lower than cable penetration rates, which reached 68.2 percent in 1997.[13] While there may be other explanations why PCO penetration rates in MDUs are below average cable penetration rates, the significant disparity between these two rates may suggest that PCOs are exercising market power by charging supra-competitive rates or offering lower quality services to MDU tenants.[14]

In addition, the prevalence of exclusive service contracts as a means of recovering the cost of sunk investments in the MDU market suggests that considerations other than investment recovery may be motivating PCOs and MDU owners. Exclusivity is only one of many methods that PCOs and other MVPDs could employ to recover such costs. Other methods, which would not necessarily preclude MDU owners from permitting in-building competition, include contract termination penalties, buyout clauses, or

---

12 Whinston Study at 8.

13 *Fourth Cable Competition Report*, FCC 97-423 at para. 15 ("Cable penetration (the proportion of homes passed that actually subscribe) also grew, increasing from 67% at the end of 1995 to 67.8% at the end of 1996, and 68.2% at the end of the first half of 1997.").

14 This disparity also tends to confirm that, as discussed above (*see supra* note 11), the cost and quality of video services have little effect on a tenant's decision to rent a particular MDU, and that, if anything, some tenants will decline to subscribe to expensive or low quality video services rather than move to a new MDU. Consequently, MDU owners are not, as Professor Whinston would have the Commission believe, forced to act as *de facto* representatives for their tenants in negotiations with MVPDs.

guaranteed minimum revenue levels. From a public interest perspective, such methods are far preferable to exclusive service contracts because they do not stifle competition or limit consumer choice to the same extent. In a competitive marketplace, one would expect MVPDs to employ a variety of methods to recover sunk investment costs in order to meet the particular demands of individual MDU owners and tenants. The fact that PCOs do not employ, and MDU owners appear not to demand, other methods suggests that PCOs and MDU owners may be using exclusive service arrangements for reasons other than recovering sunk investments.

Moreover, the extent to which PCOs' investment costs are sunk (that is, cannot be recovered when a firm exits the market, or, in this case, a building) may be significantly overstated because PCOs may be able to redeploy much of the facilities and equipment used to provide video service to MDUs. To the extent such facilities and equipment can be salvaged and used for other purposes or in other buildings, PCOs have no need for long-term exclusivity to recoup their investments in MDUs. Ameritech submits that it is incumbent upon proponents of long-term exclusivity to demonstrate that the assets used to provide video services to MDUs cannot be redeployed – they have not done so.

Finally, Professor Whinston asserts that PCOs are much less likely to be active in states with mandatory access statutes, which make exclusive service contracts with competitors to franchised cable operators impossible.[15] Professor Whinston claims that this reduced PCO activity in mandatory access states demonstrates that exclusive service

[15] In support of this assertion, Professor Whinston relies on unspecified anecdotal evidence, and responses to an ICTA survey of its members that was not submitted in the record. *See* Whinston Survey at 16. Ameritech submits that the Commission should give no weight to this ICTA survey, which has not been made available for public scrutiny and comment.

arrangements are necessary to encourage PCOs to invest in MDUs.[16] Professor Whinston's conclusions are, however, completely at odds with the Commission's findings in the *Fourth Cable Competition Report*. In that *Report*, the Commission found that "the growth markets for SMATV firms are in[, *inter alia*,] . . . Florida, and major urban centers with large numbers of MDUs, such as . . . Chicago, [and] New York . . .,"[17] each of which is subject to some form of mandatory access law.[18] They are also undercut by OpTel's recent purchase of SMATV systems in several cities in mandatory access states, including Miami, Orlando, Tampa, and Chicago.[19] The fact that PCOs are not only surviving, but indeed expanding and thriving, in markets with mandatory access statutes suggests that, contrary to Professor Whinston's findings, exclusivity is not necessary to encourage PCOs, or other alternative video services providers, to invest in MDU facilities.

In sum, Professor Whinston's report is based on false assumptions, offers little or no evidence or factual data to support his analysis and opinions, employs faulty reasoning, and is contradicted by the Commission's own findings. The Commission should, therefore, reject Professor Whinston's findings.

---

16 *Id.*.

17 *Fourth Cable Competition Report*, FCC 97-423 at para. 84.

18 *In the Matter of Telecommunications Services Inside Wiring, Customer Premises Equipment; In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Cable Home Wiring*, CS Docket No. 95-184, MM Docket No. 92-260, Report and Order and Second Further Notice of Proposed Rulemaking, FCC 97-376 at para. 182 (rel. Oct. 17, 1997).

19 Communications Daily, Warren Publishing, Inc., Volume 18, No. 45 (Mar. 9, 1998).

In addition, the Commission should reject OpTel's claim that limiting its right to negotiate exclusive contracts for MDUs would be a "devastating blow to its prospects" by limiting its ability to attract the capital necessary to compete.[20] In support of this assertion, OpTel submits a letter from Salomon Brothers that states that "reducing the exclusivity period [in exclusive service contracts for MDUs] to seven years would make it more difficult to attract new investments in OpTel."[21] This letter does not, however, establish that a ban on exclusive service arrangements for MDUs would deter efficient or innovative investment, but rather states the obvious fact that it is far easier to attract capital to an unregulated monopoly protected by barriers to entry than to service providers subject to vigorous competition.[22]

Ameritech submits that the critical question in this proceeding is not whether exclusive service contracts promote investment (which they assuredly do), but rather whether they promote competition and consumer choice in the MDU market, and whether there are alternative methods of ensuring access to investment capital that do not restrict consumer choice. Thus, the Commission should not focus solely on whether eliminating exclusive service contracts would limit the ability of some inefficient service providers to attract low-cost financing, and, therefore, seek to protect certain classes of competitors or guarantee winners and losers in the marketplace, but rather on its

---

[20] OpTel Reply at 4.

[21] OpTel Reply, Attachment A (Letter from Robert J. Gemmell, Salomon Brothers, Inc., to Bertrand Blanchette, OpTel Chief Financial Officer (July 18, 1997)).

[22] As Commissioner Ness recently observed, attracting capital to a monopolist with a guaranteed rate of return that exceeds the cost of capital is never a problem, but such investment "doesn't do much for innovation, or efficiency." *Why Investment Matters*, Remarks of Commissioner Susan Ness Before the Economic Strategy Conference, Washington, D.C. (Mar. 3, 1998).

congressionally mandated duty to promote competition and consumer choice for all viewers, including MDU tenants.

III. Conclusion

For the foregoing reasons, the Commission should reject the arguments of ICTA and OpTel that exclusive service contracts between competitive MVPDs and MDUs are procompetitive and should not be regulated, and prohibit exclusive service contracts between all MVPDs and MDU owners. If the Commission nevertheless decides to permit exclusive service contracts for MDUs, it should strictly limit the duration of such exclusivity to the minimum period necessary for MVPDs to recover their sunk investment costs.

Respectfully submitted,

Christopher M. Heimann
Counsel for Ameritech
Suite 1020
1401 H Street, N.W.
Washington, D.C. 20005
202-326-3818

March 16, 1998

CERTIFICATE OF SERVICE

I, Toni R. Acton, do hereby certify that a copy of the foregoing Surreply of Ameritech on Second Further Notice of Proposed Rulemaking has been served on the parties listed on the attached service list, by first class mail, on this 16th day of March 1998.

By: Toni R. Acton
Toni R. Acton

Daniel L. Brenner
Michael S. Schooler
David L. Nicoll
NCTA
1724 Massachusetts Avenue, NW.
Washington, DC 20036

Michael H. Hammer
Francis M. Buono
Todd Hartman
Willkie Farr & Gallagher
Attorneys for Tele-Communications, Inc.
Three Lafayette Centre
1155 21st Street, NW
Suite 600
Washington, DC 20036

John E. Raposa, HQE03J27
GTE Service Corporation
PO Box 152092
Irving, TX 75015

Gail L. Polivy
GTE Service Corporation
1850 M Street, NW
Suite 1200
Washington, DC 20036

Henry Goldberg
W. Kenneth Ferree
Goldberg, Godles, Weiner & Wright
Attorneys for OpTel, Inc.
1229 19th Street, NW
Washington, DC 20036

Michael E. Katzenstein
Vice President and General Counsel
OpTel, Inc.
1111 W. Mockingbird Lane
Dallas, TX 75247

James White
Margaret A. Sofio
Attorneys for US West, Inc.
The Pilot House
Lewis Wharf
Boston, MA 02110

Brenda Fox
Gregory L. Cannon
Matthew P. Zinn
Attorneys for US West, Inc.
Suite 700
1020 19th Street, NW
Washington, DC 20036

Jean L. Kiddoo
Lawrence A. Walke
Swidler & Berlin, Chartered
Counsel for RCN Telecom Services, Inc.
3000 K Street, NW
Suite 300
Washington, DC 20007

Deborah C. Costlow
Treg Tremont
Arent Fox Kintner Plotkin & Kahn
Attorneys for Independent Cable and
Telecommunications Association
1050 Connecticut Avenue, NW
Washington, DC 20036

Alexandra M. Wilson, Esq.
Cox Enterprises, Inc.
1320 19th Street, NW
Suite 200
Washington, DC 20036

Stephen R. Effros
James H. Ewalt
Cable Telecommunications Association
3950 Chain Bridge Road
PO Box 1005
Fairfax, VA 22030

Frank W. Lloyd
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
Attorneys for Cable Telecommunications Association
701 Pennsylvania Avenue, NW
Washington, DC 20004

Nicholas P. Miller
William Malone
Miller & Van Eaton, P.L.L.C.
Attorneys for Building Owners and Managers Association International, Institute of Real Estate Management et al
1150 Connecticut Avenue
Suite 1000
Washington, DC 20036

Gerard Lavery Lederer
Vice President - Industry and Government Affairs
Builders Owners and Managers Association International
1201 New York Avenue, NW
Suite 300
Washington, DC 20005

Roger Platt
National Policy Counsel
National Realty Committee
1420 New York Avenue, NW
Suite 1100
Washington, DC 20005

Paul J. Sinderbrand
Robert D. Primosch
Wilkinson, Barker, Knauer & Quinn, LLP
Attorneys for The Wireless Cable Association International, Inc.
2300 N. Street, NW
Suite 700
Washington, DC 20037

Lawrence W. Katz
Attorney for The Bell Atlantic Telephone Companies
1320 North Court House Road
Eighth Floor
Arlington, VA 22201

Aaron I. Fleischman
Arthur H. Harding
Jill Kleppe McClelland
Susan A. Morrt
Fleischman and Walsh, L.L.P.
Attorneys for Time Warner Cable
1400 16th Street, NW
Suite 600
Washington, DC 20036

Mary J. Sisak
Mary L. Brown
Attorneys for MCI Telecommunications Corporation
1801 Pennsylvania Avenue, NW
Washington, DC 20006

Joseph S. Paykel
Gigi B. Sohn
Andrew Jay Schwartzman
Media Access Project
1707 L Street, NW
Suite 400
Washington, DC 20036

Kevin C. Gallagher
Senior Vice President - General Counsel and Secretary
360° Communications Company
8725 Higgins Road
Chicago, IL 60631

Terry S. Bienstock. P.A.
Philip J. Kantor, Esq.
Bienstock & Clark
Attorneys for CableVision Communications, Inc., Comcast Cable Communications, Inc. and Tele-Media Corporation of Delaware
200 S. Biscayne Blvd.
Suite 3160
Miami, FL 33131

Eric E. Breisach, Esq.
Bienstock & Clark
Attorneys for CableVision Communications, Inc., Comcast Cable Communications, Inc. and Tele-Media Corporation of Delaware
5360 Holiday Terrace
Kalamazoo, MI 49009

Rodney D. Clark, Vice President
Government and Public Affairs
Lara E. Howley, Esq.
Manager, Foundation and Special Projects
Community Associations Institute
1630 Duke Street
Alexandria, VA 22314

James F. Rogers
Nandan M. Joshi
Latham & Watkins
DIRECTV, Inc.
1001 Pennsylvania Avenue, NW
Suite 1300
Washington, DC 20004

Timothy Graham
Robert Berger
Russell Merbeth
Barry Ohlson
Joseph Sandri, Jr.
Winstar Communications, Inc.
1146 19th Street, NW
Suite 200
Washington, DC 20036

Patricia Y. Lee
Marvin Rosenberg
Holland & Knight LLP
Counsel for United States Satellite Broadcasting Company, Inc.
2100 Pennsylvania Avenue, NW
Suite 400
Washington, DC 20037-3202

Jeffrey L. Sheldon, General Counsel
Sean A. Stokes, Associate General Counsel
UTC, The Telecommunications Association
1140 Connecticut Avenue, NW
Suite 1140
Washington, DC 20036

Mr. Robert L. James
Mr. Paul Glist
Cole, Raywid & Braverman, LLP
Attorneys for Charter Communications, Inc. Greater Media, Inc., Jones Intercable, Inc., Marcus Cable Operating Company, et al.
1919 Pennsylvania Avenue, NW
Suite 200
Washington, DC 20006

Arthur H. Harding
Susan A. Mort
Fleischman and Walsh, LLP
Attorneys for Adelphia Communications
Corporation, Pennsylvania Cable TV
Association and Suburban Cable TV Company
1400 16th Street, NW
Suite 600
Washington, DC 20036